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March 14, 2000

BY HAND

Magalie R. Salas, Esq.
Secretary
Federal Communications Commission
The Portals
445 Twelfth Street, S.W.
12th Street Lobby, TW-A325
Washington, D.C. 20554

Re: *CC Docket No. 98-184; Ex Parte Filing*

Dear Ms. Salas:

Enclosed are two copies of a written *ex parte* entitled "Reply of Bell Atlantic and GTE to AT&T's March 10 *ex parte*: The DataCo Proposal Is Fully Consistent With the Communications Act and Furthers the Purposes of Section 271," to be filed on the public record in the above-referenced docket. By copy of this letter, I am hand delivering this document to the persons listed below.

If you have any questions, please contact me.

Very truly yours,

Steven G. Bradbury

Enclosure

cc (w/encl.): Dorothy Attwood
Rebecca Benyon
Michelle Carey
Kyle Dixon
Jordan Goldstein
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March 14, 2000

REPLY OF BELL ATLANTIC AND GTE TO AT&T'S MARCH 10 EX PARTE: THE DATACO PROPOSAL IS FULLY CONSISTENT WITH THE COMMUNICATIONS ACT AND FURTHERS THE PURPOSES OF SECTION 271

Bell Atlantic and GTE submit this paper in reply to AT&T's March 10 *ex parte* letter, *see* Ex Parte Letter from Peter D. Keisler to Magalie Roman Salas, March 10, 2000 (hereinafter "AT&T Ex Parte"), and its attached Declaration of Professor John C. Coffee, Jr. (hereinafter "Coffee Decl.").

INTRODUCTION

The central thrust of AT&T's argument is that our DataCo structure depends on an interpretation of the Communications Act's "affiliate" definition that vaunts "form" over "substance." AT&T Ex Parte at 2. In truth, it is AT&T that urges a formalistic analysis by blindly citing cases and rules lifted from the securities laws that do not in any way share the same statutory purposes as the Communications Act in general or section 271 in particular. The securities law sources relied on by AT&T and its securities expert are irrelevant to the issue of equity ownership and control under sections 3(1) and 271 and do nothing to undercut the fundamental corporate law principles that support our DataCo proposal. In short, AT&T is ignoring the *substance* of the Communications Act and corporate law in favor of the inapposite *formalities* of the securities laws.

As Professor Gilson explains in his Supplemental Declaration, appended hereto, the purposes of the securities laws are "entirely different" from the "ends sought to be achieved by section 271 and section 3(1)." Supplemental Declaration of Professor Ronald J. Gilson ¶ 5 (hereinafter "Gilson Supp. Decl."). The Communications Act bars Bell operating companies, or "BOCs," from providing interLATA services through an "affiliate" because doing so would allow them to circumvent section 271's "requirement of FCC approval" before entering in-region interLATA markets. *Id.*; *see AT&T v. Ameritech*, 13 FCC Rcd 21438, ¶ 24 (1998) (section 271 assures that "neither a BOC nor a BOC affiliate" may provide interLATA services until "the Commission approves the application of such company"). Section 271 and the Act's definition of affiliate are thus ultimately concerned with "ownership – the capacity of a party to control, through ownership of an equity interest, another entity that is providing the service for which approval is required." Gilson Supp. Decl. ¶ 5.

The securities laws, on the other hand, are intended to stem irregularities in the trading of *any* valuable financial instrument – "prohibiting insider trading, assuring disclosure, and preventing fraud." *Id.* ¶ 4; *see also* Jesse Choper, John C. Coffee & Ronald J. Gilson, Cases and Materials on Corporations 314-17 (4th ed. 1995) (purposes of the securities laws are promoting disclosure, preventing fraud, and informing professional investors). By definition then, the securities laws are concerned with regulating the trading of options and convertible securities, irrespective of the fact that those instruments come with "no corporate participation rights" and "no capacity to control." Gilson Supp. Decl. ¶ 6.

Indeed, completely absent from AT&T's submission is any discussion of section 271's structure or objectives. Section 271 gives BOCs an incentive to open their local markets to competition by allowing them to offer "a comprehensive package of telecommunications services" only if they have complied with the Act's market-opening requirements. *AT&T v. Ameritech*, 13 FCC Rcd 21438, ¶ 5. Further, section 271 is designed to discourage BOCs from using their local exchange facilities to discriminate against providers of interLATA services. *Id.* Thus, so long as the DataCo proposal *increases* Bell Atlantic/GTE's overall incentives to open its local markets to competition, the proposal *furthers* the purposes of section 271.

The Act's definition of "affiliate" must be interpreted in light of these purposes. *See, e.g., id.* ¶ 37 ("[I]n giving meaning to the scope of the in-region, interLATA restriction, we must consider the dual objectives of section 271, as well as the careful balance struck by Congress in the Act's overall structure and framework."). As explained in our February 22 Response,[1] by owning only a 10% current equity interest in DataCo with a conversion option to reacquire control by increasing its ownership interest once it achieves interLATA relief, the merged Bell Atlantic/GTE will have a dramatically *enhanced* incentive to comply with section 271. Specifically, the proposed option structure will allow Bell Atlantic/GTE to enter immediately the ranks of top-tier Internet backbone providers once it secures the necessary 271 approvals. Likewise, the option structure will allow the combined company to realize substantial vertical synergies with DataCo – by marketing services to customers that conduct business nationwide – promptly after gaining section 271 relief.

The Commission just recently confirmed the power of this incentive in its order conditionally approving the merger of U S WEST and Qwest. Qwest, like DataCo, operates a network equipped to serve customers across the United States. The Commission recognized that "Qwest has strong business incentives to make full use of its long distance network and Internet backbone by providing service throughout the country to its clients that conduct business nationwide." *In re Qwest Communications Int'l Inc. and US West, Inc.*, CC Docket No. 99-272, ¶ 57 (rel. Mar. 10, 2000) (hereinafter "US West/Qwest Order"). Nevertheless, Qwest will not be able to implement this national marketing strategy, and thereby secure the "maximum growth in its out-of-region business," until U S WEST secures 271 approvals for its states. *Id.* The merger thus created, in the Commission's words, "powerful new incentives" for U S WEST to open its local markets to competition. *Id.* ¶ 2.

Bell Atlantic/GTE's option to take a controlling interest in DataCo, conditioned on obtaining the necessary interLATA relief, creates precisely the same "powerful new incentive" for the combined company to comply with section 271. Indeed, the incentive is even stronger here because DataCo, unlike Qwest, is one of only four top-tier Internet backbone providers. The vertical and geographical synergies between DataCo and Bell Atlantic/GTE are therefore even more powerful than those between U S WEST and Qwest. Moreover, because DataCo is the only top-tier Internet

[1] Response of Bell Atlantic and GTE in Support of Proposal to Transfer GTE Internetworking to a Separate Corporation Owned and Controlled By Public Shareholders (filed Feb. 22, 2000) (hereinafter "Response").

backbone provider not owned by one of the Big Three IXCs, it represents Bell Atlantic/GTE's only hope to step rapidly into the concentrated top tier of the Internet backbone market.

Certainly, Bell Atlantic/GTE's pre-paid option (the conversion rights attendant to its Class B stock) will have considerable market *value* (after all, the option represents the only consideration received for GTE's surrender to the public shareholders of ownership and control over GTE Internetworking). But the fact that Bell Atlantic/GTE may benefit from an increase in that value (by, for example, selling its shares with their conversion rights to a third party if it fails to secure sufficient interLATA relief within five years) hardly means that it will own the equivalent of a controlling equity interest in DataCo in violation of section 271.

Section 271 is concerned only with a BOC's unauthorized "participat[ion]" or "involvement" in long distance markets, either directly or through an "affiliate." *AT&T v. Ameritech*, 13 FCC Rcd 21438, ¶¶ 36-37. As the Commission has repeatedly ruled, violations of 271 turn on whether a BOC (i) is receiving "material benefits" "*uniquely associated with the ability to include a long distance component in a combined service offering*," (ii) is "effectively holding itself out as a provider of long distance service," and (iii) is "performing activities and functions" typically performed by an IXC. *Id.* ¶ 37 (emphasis added); *see U S WEST/Qwest Order*, CC Docket No. 99-272, at ¶ 18. In other words, section 271 is not a punitive provision that requires BOCs to forfeit any financial benefits gained from passive investments, but rather is directed at benefits that flow from active participation in the provision of long distance services, including services provided through an "affiliate." Our proposal entails none of these sorts of active participation by Bell Atlantic/GTE in DataCo's interLATA functions.

Thus, whatever gain in value Bell Atlantic/GTE may realize from its passive conversion rights in DataCo cannot *per se* violate 271. For one thing, the same aggregate gain could lawfully be realized from a 10% investment in each of eight different comparable Internet companies, expressly authorized by the "affiliate" definition. Moreover, *GTE would realize the very same gain even if it sold GTE Internetworking free and clear to a third-party buyer today*, since the sale price for the business would necessarily include the present value of any expected future appreciation in the enterprise. Bell Atlantic would fully realize the "benefit" of that gain through its merger with GTE, since the merger price (in the form of a negotiated stock ratio) is fixed by contract. Finally, Bell Atlantic could receive a similar return simply from investing in a mutual fund that holds stock in high-valued Internet companies. Yet, in none of these three scenarios could anyone legitimately argue that Bell Atlantic would violate section 271 by receiving the "benefit" of such a gain in value, since Bell Atlantic would not have "participated" in the provision of long distance services or enjoyed the benefits "uniquely associated with the ability to include [Internet backbone services] in a combined service offering." The same is true with the DataCo structure, under which Bell Atlantic/GTE will participate in marketing DataCo's Internet services only where and as permitted by section 271.

AT&T's *ex parte* submission ignores all of these points. Further, AT&T's submission declines to revive AT&T's earlier, and wholly specious, claim that Bell Atlantic/GTE would have the incentive and ability to discriminate in favor of DataCo (a claim squarely rebutted by the

Declaration of Raymond F. Albers, attached to our Response). Thus, AT&T's *ex parte* completely neglects the "substance" behind section 271 and the Act's definition of "affiliate" and prefers instead to stitch together a patchwork quilt of inapposite cases and regulations from the securities laws. Indeed, AT&T never even bothers to explain why the securities laws present an appropriate analog for interpreting the Communications Act.

Ultimately, AT&T's reliance on the securities laws proves far too much. Under the securities laws, *all options*, whether for one share or for one million shares of a publicly traded company, are treated as equity securities. AT&T Ex Parte at 4. Thus, under AT&T's proffered view, a BOC would violate section 271 by acquiring an option to purchase 10.1% of a company that provides in-region interLATA services, even if that option could not be exercised without 271 approval. The Commission has repeatedly rejected this approach, in its attribution, cross-ownership, and other rules, and in numerous individual adjudications.[2] Likewise, in administering the MFJ, Judge Greene rejected the categorical approach dictated by AT&T's application of the securities laws and frequently allowed the BOCs to acquire conditional interests in companies participating in prohibited lines of business. *See* Supplemental Filing of Bell Atlantic and GTE, Jan. 27, 2000, at 35-43 (hereinafter "Supp. Filing"). These precedents – as well as the plain language of section 3(1) and the purposes of section 271 – compel the conclusion that Bell Atlantic/GTE's DataCo proposal is fully consistent with the Communications Act.

DISCUSSION

I. BELL ATLANTIC/GTE WILL NOT "OWN" DATACO WITHIN THE MEANING OF THE COMMUNICATIONS ACT.

The starting point for any question of statutory interpretation is the plain language of the statute. Section 3(1) of the Communications Act, the controlling definition of "affiliate," refers to ownership only in the present tense ("owns," "is owned," "is under common ownership"), and thus

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[2] AT&T's own fillings in defense of its MediaOne merger prove that AT&T does not believe its own argument. As confirmed by Time Warner's 10-K filing with the SEC, "MediaOne has an option to obtain an additional 6.33%" ownership share in Time Warner Entertainment (TWE), "exercisable at any time through May 2005." Time Warner, Inc., 1998 10-K, at 91 (Mar. 26, 1999). Nevertheless, in describing MediaOne's "ownership interest" in TWE, AT&T has consistently referred only to MediaOne's *present* 25.51% interest. *Ex Parte Comments of AT&T and MediaOne*, CS Docket No. 99-251, at 8 (Nov. 24, 1999) (MediaOne "has a 25.51% ownership interest" in TWE); *see also id.* at 1 ("MediaOne currently holds a 25.51% limited partnership interest" in TWE); *Ex Parte Reply Comments of AT&T and MediaOne*, CS Docket No. 99-251, at 44 (Dec. 21, 1999) (after merging with MediaOne, AT&T will own only a "25.51 percent stake in Time Warner"). Indeed, in AT&T's Public Interest Statement filed in connection with the MediaOne merger, AT&T stated that MediaOne only "has a 25.51 percent interest in TWE" and that the "remaining 74.49 percent interest in TWE is held by Time Warner." *Applications and Public Interest Statement*, CS Docket No. 99-251, at 16 (July 7, 1999); *see also id.* at Appendix B (identifying MediaOne "ownership" in TWE at 25.51%). MediaOne's option in TWE is mentioned *nowhere* in AT&T's ubiquitous merger filings, confirming AT&T's true belief that options do not represent a present equity ownership interest.

establishes that only current equity interests (and not potential future equity interests, like options or other conversion rights) are counted against the 10% ownership ceiling. *See Sutton v. United Air Lines*, 119 S. Ct. 2139, 2146 (1999) (holding that because a statute defined "disability" in the "present indicative verb form" as an "impairment that substantially limits" a major life activity, the statute "requir[es]" that a person "be presently – not potentially or hypothetically – substantially limited in order to demonstrate a disability"); *United States v. Wilson*, 503 U.S. 329, 333 (1992) ("Congress' use of a verb tense is significant in construing statutes.").

Section 3(1)'s focus on current equity interests follows from the purposes of section 271. Section 271 is designed to deny BOCs, prior to Commission approval, the "significant competitive advantages" that stem from providing "customers with combined packages of local and long distance services." *AT&T v. Ameritech*, 13 FCC Rcd 21438, ¶ 7. It is thus ultimately concerned with regulating the BOCs' "opportunity to participate" actively in interLATA markets. *Id.* ¶ 36. Accordingly, when determining whether a BOC is providing services in violation of section 271, the Commission considers whether the company's "*involvement* in the long distance market enables it to obtain competitive advantages, thereby reducing its incentive to cooperate in opening its local market to competition." *Id.* ¶ 37 (emphasis added). In particular, to determine if a BOC is violating section 271, the Commission considers:

> whether the BOC obtains material benefits (other than access charges) *uniquely associated with the ability to include a long distance component in a combined service offering*, whether the BOC is *effectively holding itself out* as a provider of long distance service, and whether the BOC is *performing activities and functions* that are typically performed by those who are legally or contractually responsible for providing interLATA service to the public.

Id. (emphasis added); *see US WEST/Qwest Order*, CC Docket No. 99-272, at ¶ 18. In short, section 271 is aimed at ensuring that BOCs do not *actively participate* in interLATA markets. In this regard, it denies BOCs the "unique advantages" that come from vertical integration and the use in interLATA markets of special BOC assets and expertise.

The purpose of section 3(1)'s affiliate definition is to ensure that these limitations on BOC conduct are not circumvented through relationships with other companies. For a BOC to circumvent the limitation of section 271 through another company – *i.e.*, an "affiliate" under section 3(1) – the BOC must have the ability to control it. Gilson Supp. Decl. ¶ 24. In other words, the BOC "must have the capacity to influence the business decisions of the affiliated entity." *Id.* Thus, section 3(1)'s 10% cap on equity ownership reflects Congress's judgment that ownership in excess of 10% reflects an unacceptable level of control. In effect, the 10% ownership cap is an attribution rule – a presumption that ownership in excess of 10% grants control. By also including the word "control" in section 3(1), Congress intended to capture arrangements other than traditional equity interests that nevertheless confer control through actual participation in day-to-day operations, even if the person does not have the *de jure* rights that come with equity ownership.

Because the focus of the section 271 ownership inquiry is on the capacity of a party to control – through an equity interest – another entity that is providing interLATA services, an "equity interest (or the equivalent thereof)" is appropriately defined by reference to the traditional corporate *participation rights* that characterize equity: voting rights (the right to participate in corporate decision making through voting); earning rights (the right to participate in corporate earnings through the receipt of dividends); and liquidation rights (the right to participate in the proceeds of the corporations's liquidation on dissolution). *See* Gilson Supp. Decl. ¶ 10; Declaration of Professor Ronald J. Gilson ¶ 15 (Feb. 22, 2000) (hereinafter "First Gilson Decl."). When a party holds an interest (like an option or other conversion right) that does not confer the current right to vote, participate in dividends, and participate in liquidation distributions, a party has no capacity to participate in (and therefore control) the actions of another entity offering in-region long distance services. *See* Gilson Supp. Decl. ¶ 11.

By contrast, any proposed "affiliate" test that is keyed instead to the *market value* of an instrument held by a BOC would do nothing to further the purposes of section 271. Section 271 induces BOCs to open their local markets by denying them the special advantages of actively participating in interLATA markets; it does not gratuitously bar BOCs from investing in long distance companies and earning significant returns. Such investments are expressly allowed, so long as they do not involve active participation and control. Indeed, any other application of the "affiliate" definition that turns on the *value* of an investment alone would be divorced from the purposes of section 271, since it would be wholly unrelated to the unique benefits of participating in the prohibited business.

With these background principles in mind, we turn to AT&T's arguments.

A. Options vs. Conversion Rights. AT&T claims, first, that Bell Atlantic/GTE will own a single instrument, Class B stock, that "carr[ies] all three of the 'indicia' of equity – voting rights, earning rights, and liquidation rights." AT&T Ex Parte at 3. But these rights will only attach to Bell Atlantic/GTE's 10% equity interest; they do not attach to the passive option portion of its interest, the right to convert its holdings to an 80% active equity interest. Bell Atlantic/GTE's option or conversion rights would give it *no* participation rights, and thus no additional equity ownership, before the option is exercised. Gilson Supp. Decl. ¶ 11. Indeed, AT&T concedes as much by recognizing that Bell Atlantic/GTE will only have a right to "80% of DataCo's earnings" if its Class B shares are "converted in the near future." AT&T Ex Parte at 2; *see also* Coffee Decl. ¶ __ ("the class B stock receives 10% of DataCo's voting and distribution rights *and can be converted* into 80% of its voting and distribution rights (for five years)") (emphasis added).[3]

[3] AT&T further claims that Bell Atlantic/GTE's investor safeguards will confer voting rights on the option portion of its investment and will give it earnings rights by allowing it to block the payment of dividends to the public shareholders. *See* AT&T Ex Parte at 5; Coffee Decl. ¶ 25. As we discussed thoroughly in our prior submissions, however, our proposed investor safeguards will apply only to extraordinary actions taken by DataCo, while the voting and other participation rights that characterize current equity interests apply to the ordinary and day-to-day operation of the business. *See* Supp. Filing at 44-48; Response at 6, 14-20.

AT&T also asserts that Bell Atlantic/GTE's option will be a sham. *See* AT&T Ex Parte at 3. AT&T is wrong for three reasons. *First*, Bell Atlantic/GTE will pay valuable consideration for the conversion option by surrendering 90% of the ownership and all control of GTE Internetworking to the public shareholders for an indefinite period of time. *See* Supp. Filing at 30. When DataCo is taken public, it is DataCo that will receive the cash raised from the IPO, not Bell Atlantic/GTE. In other words, Bell Atlantic/GTE will pay for its option with 90% of GTE-I's nationwide data business.

Second, there is indeed a genuine contingency that Bell Atlantic/GTE may not get DataCo back, since there is a very real possibility that Bell Atlantic/GTE will either not be able to exercise its conversion rights within five years or will choose instead to sell its Class B stock for market value. The exercise of the option will be directly contingent on Bell Atlantic/GTE's ability to secure sufficient interLATA relief to operate the DataCo business with five years – a true and unpredictable contingency, given that only one 271 approval has been granted in the past four years. *See* Supp. Filing at 6-7. Indeed, in the MFJ context, Judge Greene held that the necessity of "regulatory and judicial approvals" was sufficient to establish "that the occurrence of contingencies permitting NYNEX to enhance its interest in Tel-Optik [was] genuinely in question." *United States v. Western Elec. Co.*, No. 82-0192, at 6-7 (D.D.C. Aug. 7, 1996); *see also In re Richard R. Zaragoza*, 14 FCC Rcd 1732, ¶ 20 (1998) ("purchase options and other potential future rights are noncognizable for current attribution purposes," and the Commission will not "presum[e] that [an] option[] will be exercised," even where the purchase price for the option is paid "up front").

Third, it makes no difference for section 271 purposes that Bell Atlantic/GTE may sell its Class B stock with its option in the future (to another party who will exercise the option) and thereby may realize the option's full market value. Obviously, there can be no problem under section 271 in allowing Bell Atlantic/GTE to exit its interest in the option and give up the right to get DataCo back. And the fact that Bell Atlantic/GTE will receive value for the option when sold is only fair, since GTE paid full value in kind with the assets of GTE Internetworking. Sections 3(1) and 271 expressly allow BOCs to hold passive investments that appreciate in value, so long as they do not have the present participation and control rights that come with ownership above 10%. *See AT&T v. Ameritech*, 13 FCC Rcd 21438, ¶¶ 36-37. The determinative point is that before the option is exercised, it will confer on Bell Atlantic/GTE no present rights of equity ownership.

B. Market Value vs. Ownership Rights. Next, AT&T argues that Bell Atlantic/GTE's option is *equivalent in value* to an additional 70% equity interest, and therefore that it is covered by section 3(1)'s "equivalent" language. AT&T Ex Parte at 3. But the one dictionary definition proffered by AT&T – that "equivalent" under section 3(1) means "equal value" – bears no rational relationship to the purposes of section 271. Section 271 is concerned with prohibiting a BOC's unauthorized "participat[ion]" or "involvement" in long distance markets, *AT&T v. Ameritech*, 13 FCC Rcd 21438, ¶¶ 36-37, as well as a BOC's receipt of the "material benefits (other than access charges) *uniquely associated with the ability to include a long distance component in a combined service offering*." *Id.* ¶ 37 (emphasis added); *see U S WEST/Qwest Order*, CC Docket No. 99-272, at ¶ 18. It is thus concerned with *control equivalence*, not *value equivalence*. Gilson Supp. Decl.

¶ 26. Because an option does not confer any rights to participate and control, an option cannot be an equity interest or its equivalent, regardless of its market value. *Id.* ¶ 26.

The example of employee stock options illustrates "the error in equating value equivalence and control equivalence." *Id.* ¶ 27. Suppose an employee receives stock options with an exercise price of $1 a share and with the common restriction that the options cannot be exercised for 12 months. After the company goes public a few months later at $40 a share, the employee's options have a value of $39 a share (roughly the equivalent of the value of the equity into which the options are convertible). But because the options convey no participation rights until they are exercised, there is *value* equivalence but not *control* equivalence. It is for this reason that the option only becomes an equity interest under section 3(1) when, through its conversion, the holder gains participation rights that allow it to influence the company's business decisions. *See id.* In the same way, before the exercise of its option, Bell Atlantic/GTE will have only a 10% equity interest in DataCo, and its option will not be an equity "equivalent" because it will confer none of the participation rights of equity until exercised.

Moreover, any gain in value Bell Atlantic/GTE may realize from its conversion rights in DataCo cannot *per se* violate 271. The same aggregate gain could be realized from a 10% investment in each of eight different Internet companies – an investment strategy expressly authorized by section 3(1)'s definition of "affiliate." In addition, GTE would realize the same gain if it sold GTE-I free and clear to a third-party buyer today, since the sale price for the enterprise would include the present value of any expected future appreciation in GTE-I's business. And Bell Atlantic would fully realize the "benefit" of that gain by way of its merger with GTE, since GTE would hold the cash from the sale of GTE-I and the stock exchange ratio for the merger would not be adjusted depending on the proceeds of the sale. Finally, of course, Bell Atlantic could receive a similar return simply from investing in an index or mutual fund that is targeted at high-growth Internet stocks. The economic reality is the same in all three scenarios: Bell Atlantic would receive the "benefit" of the gain in appreciation of DataCo's business, yet it could not be argued that Bell Atlantic had realized that gain through its "participation" or "involvement" in DataCo's interLATA business. Accordingly, the receipt of such market value or gain cannot amount to the improper provision of interLATA service through an "affiliate" in violation of section 271.

C. The Irrelevance of the Securities Law Precedents Cited by AT&T and Professor Coffee. AT&T maintains that "corporate law" does not recognize the bedrock distinction – discussed at length and supported by numerous citations in our Supplemental Filing and Response – between *current* equity interests and potential *future* equity interests. AT&T Ex Parte at 3 ("there is no background principle of corporate law which maintains a sharp distinction 'between an option and an equity security'"); *id.* at 2 (claiming "there is no support for" "th[e] illogical and unnatural proposition in corporate law" that an option is not a present equity interest). AT&T promises that its expert, Professor Coffee, will explain how this distinction is contrary to "basic principles of corporate" law. *Id.* at 3. But in all the many pages of their *ex parte* submission and supporting declaration, *neither AT&T nor Professor Coffee cites a single corporate law case in support of their position.* Nor does AT&T ever come to grips with the numerous corporate law authorities holding

that options and other conversion rights do not constitute equity ownership until exercised. *See* Response at 8 n.8.[4]

Instead, AT&T and Professor Coffee seek ammunition for their challenge to DataCo by launching abruptly into an extended discussion of the securities laws. Professor Coffee is right when he calls this foray into securities law a "messy digression." Coffee Decl. ¶ 8. Indeed, the professor's "messy digression" is entirely irrelevant to the issue of corporate law presented here.

The springboard for AT&T's foray is the simple and entirely unremarkable fact that the Securities Exchange Act of 1934 defines "equity security" to include options and other convertible securities. 15 U.S.C. § 78c(a)(11). *See* AT&T Ex Parte at 4; Coffee Decl. ¶ 15. That fact, however, does not suggest in any way that options or similar conversion rights constitute ownership interests or that they confer any of the voting or economic participation rights of ownership. They do not. Anyone who holds stock options in a company knows very well that the options must be exercised before the holder may vote his or her shares or receive a distribution of dividends. *See* Gilson Supp. Decl. ¶ 27. AT&T's argument that the mere definition of "security" in the Securities Exchange Act is enough to mean that options and other convertible instruments are the equivalent of equity ownership proves far too much. If that argument were true, it would invalidate all of the Commission's numerous attribution rules and other precedents holding that options do not count as ownership.

Furthermore, the securities laws serve wholly different purposes from those served by section 271, and the treatment of options as equity securities under the securities laws is designed to effectuate those very different purposes.

Section 3(1) protects the Commission's 271 approval authority by preventing a BOC from evading the Commission's jurisdiction through an affiliated business. Under this statutory scheme,

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[4] Of the five cases cited in our Response at 8 n.8 for the background rule of law that options and other conversion rights confer no ownership until they are exercised, AT&T bothers to discuss only one – *Nerken v. Standard Oil Co.* 810 F.2d 1230 (D.C. Cir. 1987). *See* AT&T Ex Parte at 5 n.3. AT&T's argument is that *Nerken* is inapposite because it turned on the separate issue of the meaning of the term "outstanding stock" rather than on "whether a prospective right to own stock is ownership under the law generally." *Id.* In *Nerken*, however, the court also stated the general rule that "one is not an owner of common stock prior to conversion of the preferred or before an option to buy has been exercised." 810 F.2d at 1232. To be sure, in the portion of *Nerken* that AT&T cites, the court also concluded that the general rule was not implicated by the facts of that case because the convertible stock at issue there would not have qualified as "outstanding" common stock regardless of whether ownership of convertible stock was ownership of the common stock. But the *Nerken* court never denied the validity of the general rule. In fact, AT&T conveniently omits the *additional* holding of *Nerken* – applying the same general rule to a *different* instrument – that the acquisition of an *option* to buy common stock does not constitute present ownership of the stock itself. *Id.* AT&T then dismisses the remaining four cases cited in our Response, apparently because they are not "federal" cases. AT&T Ex Parte at 5 n.3. But as AT&T and its securities law expert are doubtless aware, corporate law is generally a matter of state law. *See, e.g. Burks v. Lasker*, 441 U.S. 471, 478 (1979) ("Corporations are creatures of state law.") (citation omitted).

"the focus of the inquiry is on ownership – the capacity of a party to control, through ownership of an equity interest, another entity that is providing the service for which approval is required." Gilson Supp. Decl. ¶ 10.

In distinct contrast, the securities laws serve the very different purposes of *registration and disclosure* of securities, including options and other convertible instruments, in order to prevent securities *fraud* and protect the markets from unfair trading on *nonpublic information* by corporate insiders. AT&T concedes as much. *See* AT&T Ex Parte at 4-5 (acknowledging that the securities laws are designed to impose "registration and disclosure requirements") (citing, *inter alia*, *Santa Fe Indus., Inc. v. Green*, 430 U.S. 462, 477-78 (1977) (similar), and *SEC v. Savoy Indus., Inc.*, 587 F.2d 1149 (D.C. Cir. 1978) (similar)). What AT&T and their expert conveniently fail to point out is that courts construe the term "equity security" in the securities laws precisely to further these policies of registration and disclosure. Gilson Supp. Decl. ¶ 4 ("[T]he courts have interpreted the definition of the terms 'security' and 'equity security' in the federal securities laws by reference to the ends sought to be achieved by the statute."). Securities fraud and insider trading can obviously occur with respect to options to purchase stock as well as the underlying stock itself, and so it makes no difference for purposes of the prohibition on securities fraud whether the security in question is stock or a stock option.

Professor Coffee opines that the securities laws can be imported into the Communications Act wholesale because "there is strong reason to believe" that the language of the Communications Act of 1934 was modeled after language originally used in the Securities Act of 1933. Coffee Decl. ¶ 9. But both the definition of "affiliate" in section 3(1) and section 271's interLATA restriction were enacted in the *1996* Telecommunications Act and were intended by Congress to operate together as part of the same regulatory regime. *See Telecommunications: The Role of the Department of Justice*, Hearing Before the House Judiciary Committee, 104th Cong., 1st Sess., at 93 (May 9, 1995) (stating that the Act's "definition of 'affiliate' should not permit immediate RBOC entry into long distance through an entity in which they have substantial equity interest," and noting that an older version of the Act contained "a 'loophole' that appears to allow the RBOCs to enter long distance immediately by owning up to 50 percent of an entity that could provide long distance"). This regime was derived from the MFJ-era antitrust concerns about BOC participation in the long distance market. Those antitrust concerns did not animate the securities laws, nor do the concerns that produced the 1933 and 1934 Securities Acts – specifically, the stock market crash of 1929, *see* Gilson Supp. Decl. ¶ 9 – have any conceivable application to section 271.[5]

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[5] Although Professor Coffee notes that at "the time the federal securities laws and the Communications Act of 1934 were written, Congress was very concerned about the ability of promoters to control and manipulate securities through the use of options," Coffee Decl. ¶ 11, he never suggests that these concerns motivated the provisions of the 1996 Act that are at issue here, and there is nothing to indicate that they did. Professor Coffee cites *Reliance Electric Co. v. Emerson Electric Co.*, 404 U.S. 418 (1972), for his contention that Congress, in 1934, was concerned with the ability of promoters to control securities through options, and he further states that "the *Reliance* Court specifically referred to" a book that studied the use of options as a technique for manipulating securities. The opinion Professor Coffee cites, however, is not the opinion of

(continued...)

As a matter of statutory purpose as well as statutory language, then, the securities laws cited by AT&T and their securities expert are simply inapposite. Just because there may be "literally thousands of cases discussing [the terms 'control' and 'affiliate'] in . . . the LEXIS federal securities library," Coffee Decl. ¶ 8, it does not follow that these sources are relevant. Conducting a LEXIS search for the phrase "equity security" and the words "option" or "conversion" is not a substitute for analysis of statutory purpose. Gilson Supp. Decl. ¶ 6.

The securities cases relied upon so heavily by AT&T (but conspicuously absent from Professor Coffee's declaration) illustrate perfectly the irrelevance of the securities laws to the issue at hand.

One-O-One Enterprises, Inc. v. Caruso, 848 F.2d 1283 (D.C. Cir. 1988), is a securities fraud case that simply holds that an option to purchase stock is a security within the meaning of the core anti-fraud provision of the 1934 Securities Exchange Act, § 10(b), and the related Rule 10b-5. Securities fraud can obviously occur with respect to options to purchase stock as well as with stock itself: "For purposes of disclosure and rules against fraud, the sale of a security and the indirect sale of the security by means of a sale of an option to purchase the security, are functionally identical it is irrelevant if the option does not convey corporate participation rights until it is exercised." Gilson Supp. Decl. ¶ 19. This case, however, has no bearing on the section 3(1) inquiry into ownership and control.

AT&T's reliance on *Magma Power Co. v. Dow Chemical Co.*, 136 F.3d 316 (2d Cir. 1998), is similarly ineffective. *Magma Power* was an insider trading case arising under § 16(b) of the 1934 Securities Act – a provision that prohibits corporate insiders from making short-swing profits on the sale and purchase of their company's equity securities. The case applied the SEC's rule that the acquisition of a fixed-price option (as opposed to the exercise of such an option) is the triggering event for purpose of § 16(b). But the SEC's rule at issue in *Magma Power* advanced the policy underlying § 16(b) because "the insider's opportunity to profit" from his access to nonpublic information "commences when the insider engages in options or other derivative securities that provide an opportunity to obtain or dispose of the stock at a fixed price." 136 F.3d at 322. This purpose has no relevance to § 3(1), which is aimed at ownership and control of a company rather than an insider's ability to turn a profit based on nonpublic information.

Nor does *SEC v. Texas International Co.*, 498 F. Supp. 1231 (N.D. Ill. 1980), make any inroads into the bedrock principle of corporate law that an option is not a present equity interest. That case held simply that an offer to purchase creditors' claims held by a class of shareholders of a corporation going through a bankruptcy reorganization could qualify as a "tender offer" of "equity securit[ies]" within the meaning of the reporting and anti-fraud requirements of the 1934 Securities Act where the claims, while not themselves stock, could be converted into stock of the reorganized company upon consummation of the reorganization. The statutory provisions at issue in *Texas*

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[5] (...continued)
"the *Reliance* Court" but rather the *dissent* of Justice Douglas in *Reliance*. See 404 U.S. 418, 427 (1972) (Douglas, J., dissenting).

International are designed to give investors material information concerning those who make takeover bids. Gilson Supp. Decl. ¶ 21. Once again, the rationale of requiring disclosure to shareholders is totally inapplicable to the ownership and control focus of section 3(1).

Similarly, the hodgepodge of securities law materials relied upon by AT&T's securities expert bear no relation to the issues or policies involved under section 271. They too exemplify the very different anti-fraud and anti-insider-trading disclosure policies of the 1930's securities laws. For example, the "integration" doctrine and the district court case *SEC v. Cavanagh*, 1 F. Supp. 2d 337 (S.D.N.Y. 1998), upon which Professor Coffee places such great weight, *see* Coffee Decl. ¶ 26, are self-evidently concerned with the unique purposes of the securities laws. *See* 1 F. Supp. 2d at 364 (applying the "integration" doctrine after "[b]earing in mind that the policy objective of the Securities Act is 'to protect investors by promoting full disclosure of information thought necessary to informed investment decisions' and that exemptions should be interpreted 'in light of the statutory purpose.'"). And Rule 16a-4, relied on by Professor Coffee, *see* Coffee Decl. ¶ 17, which deems derivative securities and the underlying securities to which they relate to be of the same class of securities, is, once again, simply a rule that implements the insider trading provisions of § 16 of the 1934 Securities Act. *See* 17 CFR § 240.16a-4 ("For purposes of section 16 of the [1934 Securities Exchange] Act . . ."); Gilson Supp. Decl. ¶ 14. Finally, in response to Professor Gilson's use of Rule 144 under the Securities Act of 1933 to illustrate the distinction between options and equity securities, Professor Coffee points out that Rule 144 also treats simple options differently than it does options embedded within a convertible security. Of course, this proves our point: "the appropriate treatment of an option depends on the purposes of the particular regulatory structure. In some circumstances, the federal securities laws treat options differently from equity securities (and even different types of options differently), as in Rule 144; and in other circumstances treat options and equity securities the same, as in Rule 16a-4. The appropriate treatment depends on the purpose of the statute." Gilson Supp. Decl. ¶ 15. We have explained why NewCo will not own or control DataCo before exercise of its option with reference to the purpose of sections 271 and 3(1). Professor Coffee simply borrows inapposite authorities from a different statutory regime without making any attempt to tie those authorities to the purposes of the Communications Act.

D. Commission Precedents. Lastly, AT&T argues that Commission precedents support its focus on valuation rather than actual ownership rights. But AT&T's assertion that we have "largely abandon[ed] [our] reliance on Commission precedent," AT&T Ex Parte at 6, could not be further from the truth. We stand by the numerous Commission applications of the well-established rule that options and other conversion rights confer no ownership until they are exercised. *See* Supp. Filing at 35-40; Response at 8-12. Indeed, it is AT&T that now tries to avoid the Commission's rulings applying this fundamental corporate law principle.

Consider, for example, AT&T's failure to respond to the *Broadcast Attribution Order* – perhaps because it squarely follows the general rule that "nonvoting instruments such as options or warrants" are not attributable. *Review of the Commissions's Regulations Governing Attribution of Broadcast and Cable/MDS Interests*, MM Docket No. 94-150, ¶¶ 2 n.4, 26 n.66 (1999) (citing 47 CFR § 73.3555, Note 2(b) & (f)). *See also* Supp. Filing at 37; Response at 11-12 (same). Moreover, AT&T apparently concedes that – by also following the rule that future equity interests (such as

options, warrants, and conversion rights) are not attributable until exercised – the Commission's CMRS spectrum aggregation cap and LEC/LMDS cross-ownership prohibition decisions likewise undermine its case. *See* Supp. Filing at 37-38 (citing Commission precedents); Response at 12 n.9.[6]

AT&T does, however, attempt to resurrect the *Cable Attribution Order* and the "equity plus debt" rule ("ED rule"). But no matter how repackaged, those authorities still do not help its cause. They, too, follow the general rule that unexercised options and convertible interests are *not* counted as attributable interests. Indeed, this rule is explicitly stated in Note 2(e) of the cable cross-ownership rule: "Subject to paragraph (i) of this Note, holders of debt and instruments such as warrants, convertible debentures, *options or other non-voting interests with rights of conversion to voting interests shall not be attributed unless and until conversion is effected.*" 47 CFR § 76.501, Note 2(e) (emphasis added).

By its own terms, the ED rule is also consistent with the general rule that unexercised options and conversion rights are *not* attributable. In particular, the ED rule only aggregates with debt certain enumerated "equity" interests. Options and conversion rights are not included as enumerated equity interests:

> "Notwithstanding paragraphs (e) and (f) of this Note, the holder of an equity or debt interest or interests in an entity covered by this rule shall have that interest attributed if the *equity (including all stockholdings, whether voting or nonvoting, common or preferred, and partnership interests)* and debt interest or interests, in the aggregate, exceed 33 percent of the total asset value (all equity plus all debt) of that entity."

47 CFR § 76.501, Note 2(i) (emphasis added). Simply put, the types of "equity" that the ED rule aggregates with debt are "stockholdings, whether voting or nonvoting, common or preferred, and partnership interests." Unexercised options and conversion rights are not captured. The *Cable Attribution Order* confirms this straightforward interpretation, as it makes no mention of options when defining "equity" for purposes of the ED rule. *See In re Implementation of 1992 Cable Act,*

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[6] It is also odd that AT&T continues to cite *Fox Television Stations, Inc.*, 10 FCC Rcd 8452 (1995), since that case demonstrates the importance of looking at the three corporate participation rights to determine ownership. *See id.* ¶ 50 (foreign entity held greater-than-allowed interest in domestic licensee where the foreign entity had "the right to substantially all of [the licensee's] profits and losses and also [had] the right to all of [the licensee's] assets upon its sale or dissolution, less [the domestic citizen's] relatively minimal capital contribution and any accrued dividend on his preferred stock."). Beyond its application of this fundamental principle, *Fox Television* did not address whether an option is current equity ownership. However, several other foreign ownership cases do. *See, e.g. Nextwave Personal Communications, Inc.*, 12 FCC Rcd 2030, ¶ 46 (1997) ("future interests including warrants, options, and convertible debt to not constitute capital stock until exercised or converted"); *BBC License Subsidiary*, 10 FCC Rcd 10968, ¶ 20 n.12 (1995) ("future interests, such as options and convertible rights, are not relevant to our alien ownership determinations until converted"); *In re GWI PCS, Inc.*, 12 FCC Rcd 6441, ¶ 10 (1997) ("Future interests are also not factored into section 310(b) determinations."). *See also* Supp. Filing at 38-39; Response at 5 n.4.

CS Docket No. 98-82, ¶ 82 (1999) (hereinafter "*Cable Attribution Order*") (for purposes of the ED rule, "We will define equity to include all stock, whether common or preferred and whether voting or nonvoting, and all partnership interests.").

Arguing against the plain language of the Commission's rules, AT&T laments that it "would make no sense for the Commission in Note 2(e) to list specifically convertible instruments as subject to Note 2(i) if these instruments were excluded altogether from the scope of Note 2(i)." AT&T Ex Parte at 7. But the purpose of the rule refutes this claim. As the Commission noted in the *Cable Attribution Order*, the "bright-line ED test" is meant to "provide more regulatory certainty than a case-by-case approach that requires review of contract language," to "permit planning of financial transactions," to "ease application processing," and to "minimize regulatory costs." *Cable Attribution Order* ¶ 159. In light of this desire for regulatory certainty, Rule 2(e)'s clear statement that options and conversion rights are not attributable until exercised flows logically. And Note 2(i)'s enumeration of *exactly* those "equity" interests that are subject to aggregation with debt similarly advances the purpose behind the "bright-line ED test." *See* 47 CFR § 76.501, Note 2(i) (aggregating only the following "equity" interests with debt: "stockholdings, whether voting or nonvoting, common or preferred, and partnership interests"). In short, Note 2(e) is "subject to paragraph (i)" only to allow the attribution of *debt* pursuant to the scheme set forth in Note 2(i)'s ED rule. Note 2(i) does not disturb the principle, set forth in Note 2(e), that options and conversion rights are not attributable until exercised.[7]

Furthermore, AT&T's reliance on the Commission's discussion of the "LEC test" in footnote 329 of the *Cable Attribution Order* actually refutes its own argument. *See* AT&T Ex Parte at 7-8. Footnote 329 does not establish that the Commission considered options to count as equity interests. The point of that discussion was to *reject* the argument (now advanced by AT&T) that options should be attributable because of the unique treatment of options under the securities laws. *See Cable Attribution Order* ¶ 129 n.329 ("We disagree with Time Warner that options, warrants, and convertible debentures should generally be treated as beneficial interests under our rules creating an attribution simply because the SEC defines them to be beneficial interests if their owner can obtain voting stock though these securities within 60 days."). Even if footnote 329 could be read to count convertible interests like options toward the ED rule threshold in the context of the LEC test (which is ambiguous at best), such conversion rights could only be included as the equivalent of *debt*, since the rule itself excludes them in the list of equity interests.

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[7] AT&T claims that if that were the Commission's intent, "it would simply have omitted convertible instruments from 2(e) altogether." AT&T Ex Parte at 7. But if Note 2(e) did not plainly state that "options or other nonvoting interests with rights of conversion to voting interests shall not be attributed unless and until conversion is effected," it would open the door for AT&T's (now-foreclosed) argument that options *are* attributable *before* their exercise. *See* 47 CFR § 76.501, Note 2(e). That result would completely undermine the purpose of the ED rule as a "bright-line" test that "permit[s] planning of financial transactions" and "minimize[s] regulatory costs." *Cable Attribution Order* ¶ 159. Alternatively, AT&T also argues that the Commission could just have "noted that [convertible instruments] were never attributable until conversion is affected [sic]." AT&T Ex Parte at 7. But this argument is equally feckless, because that is the effect of the rules as currently drafted.

Finally, the ED rule is, in any event, plainly irrelevant to section 3(1) because the ED rule is specifically designed to capture *non-equity* interests, like debt, for attribution. Ownership under section 3(1) is explicitly limited to the ownership of "an equity interest (or the equivalent thereof)." The ED rule, by contrast, provides for the attribution of debt in certain circumstances and is, therefore, a prudential expansion meant to create a *new* rule for things that are *not* equity. Because the fundamental point of the ED rule is to take account of interests that are decidedly *not* equity, it would trump section 3(1)'s unambiguous definition of ownership if applied in that context. Indeed, in the *Cable Attribution Order*, the Commission *never* suggested that the ED rule could apply to section 3(1)'s "equity interest (or the equivalent thereof)" language. *See Cable Attribution Order* ¶ 129 ("Given that we have not adopted the Title I definition of affiliate, we need not determine what constitutes an interest 'equivalent' to an equity interest.").

AT&T is likewise wrong to suggest that a company that is an affiliate of a LEC for purposes of the LEC test, *see* 47 U.S.C. § 543, is necessarily a section 271 affiliate. AT&T Ex Parte at 8. The purpose of the LEC test is significantly *broader* than that animating section 3(1)'s definition of affiliate. The LEC test's purpose, and specifically the Commission's application of the ED rule in the LEC-test context, is to determine if a competitor to the cable monopolist has significant access to cash resources. *Cable Attribution Order* ¶ 129 ("We believe that an ED investment, given its size, by a LEC gives an MVPD significant access to the resources of a LEC such that it can be presumed that there is effective LEC competition.") (footnote 329 omitted). Given that section 3(1)'s affiliate definition is expressly limited to the ownership of equity interests, and that not even AT&T would seriously contend that debt is an equity equivalent, the fact that the LEC test counts debt (by way of the ED rule) is proof that its purpose is in fact broader than that of section 271. What is more, the section 522(2) definition of affiliate that applies in the LEC-test context is, on its face, broader than section 3(1). While section 3(1) limits ownership to mean only an "equity interest (or the equivalent thereof) of more than 10 percent," section 522(2) is void of *any* language defining ownership. *Compare* 47 U.S.C. § 522(2), *with* 47 U.S.C. § 153(1).[8]

[8] AT&T has failed to distinguish our MFJ precedents. Under the MFJ, the Justice Department approved at least one transaction, analogous to the option proposed here, where a BOC restructured a pre-existing ownership interest in a prohibited business into a conditional interest as a means of ending the violation. In May 1987, SBC bought a 21.5% voting interest in a company that engaged in research and development of specialized telephone equipment. In December 1987, Judge Greene ruled that such activities were prohibited by the MFJ's manufacturing ban. SBC sought to restructure its current equity ownership into convertible warrants that could be exercised "at a nominal price." Affidavit of Robert A. Dickemper ¶ 5 (Apr. 4, 1988), attached to Report of the United States Concerning the Proposed Retention of a Conditional Interest by Southwestern Bell Corp. (filed Apr. 15, 1988). The Justice Department approved SBC's holding the conversion rights represented by the warrants while it sought a waiver to own the prohibited business, and Judge Greene allowed the restructuring.

II. BELL ATLANTIC/GTE WILL NOT "CONTROL" DATACO WITHIN THE MEANING OF THE COMMUNICATIONS ACT.

As detailed in our Supplemental Filing and Response, Bell Atlantic/GTE will not control DataCo before exercise of the option. Actual control will rest with the public shareholders who hold 90% of the voting control of DataCo. Those shareholders will control the election of all but one director on DataCo's ten-member board, and the officers and directors of DataCo will owe their fiduciary duties to the public shareholders. *De facto* control will also remain with the public shareholders, since DataCo will be operated and managed independently, and Bell Atlantic/GTE will derive no more than 10% of the economic returns of DataCo. *See* Supp. Filing at 44-45; Response at 13-26.

AT&T's contrary arguments on this score are little more than a repackage of its earlier submission. First, relying on the Commission's old cable attribution rules, AT&T argues that even a 5% voting interest can constitute control for purposes of section 3(1)'s "affiliate" definition. AT&T Ex Parte at 9 & n.8. This argument is foreclosed by the plain language of section 3(1), which expressly permits the holding of *any* equity interest up to 10% (whether voting or non-voting).

Second, AT&T claims that DataCo's board of directors will not be truly independent because Bell Atlantic/GTE will install the first slate of directors who may then nominate themselves for a second term. According to AT&T, even if DataCo's shareholders are unhappy with the board, they will not find it worthwhile to mount a proxy fight for board control because (in AT&T's view) it is certain that Bell Atlantic/GTE will exercise its option to convert its Class B stock. AT&T Ex Parte at 10. AT&T is wrong on both counts. The initial slate of directors (other than the Class B director, who may not serve as chairman of the board) will consist of individuals with no relation to Bell Atlantic/GTE, and all of the outside directors in all matters will have to comply with the rigorous legal standards for director independence. *See* Response at 22-23. Moreover, a proxy fight for control over DataCo's board will be just as likely here as in any other context because no one will be able to predict precisely when or whether Bell Atlantic/GTE will obtain the interLATA relief necessary to exercise its conversion rights. Shareholders do not regularly look more than five years into the future in analyzing the benefits of a proxy contest. In any event, beyond the power to mount a proxy battle, DataCo's public shareholders will also have powerful litigation remedies against the board to ensure that the directors properly discharge their duties of loyalty and care.

AT&T claims that these fiduciary duties will be insufficient to protect the public shareholders' interests because, "given the breadth of the business judgment rule, there would be ample room for Bell Atlantic-affiliated directors to cause DataCo to take actions that Bell Atlantic desires without subjecting themselves to fiduciary liability." AT&T Ex Parte at 10 n.10. Once again, AT&T has the law exactly backwards. If, as AT&T hypothesizes, any DataCo director were to elevate Bell Atlantic/GTE's interests over the interests of DataCo's public shareholders (out of personal loyalty to Bell Atlantic/GTE), that would render the director "interested," and interested directors do *not* enjoy the protections of the business judgment rule. *See* D. Block, et al., *The Business Judgment Rule* 22 (4th ed. 1993); Gilson Supp. Decl. ¶ 22 n.8 (citing American Law Institute, Principles of Corporate Governance: Analysis and Recommendations §§ 4.01(c), 5.02,

1.23.). Even AT&T's own securities law expert recognizes the incorrectness of AT&T's claim. *See* Coffee Decl. ¶ 34 n.8 (acknowledging that interested directors cannot claim the "protection of the business judgment rule for interested actions").

Next, AT&T maintains that our proposed investor safeguards will give Bell Atlantic/GTE control over the day-to-day operations of DataCo. Notably absent from AT&T's argument, however, is any refutation or even acknowledgment of our previous discussion that all of these investor safeguards, *not only individually but as a package*, are typical and have been expressly held by the Commission on numerous occasions not to constitute control. Supp. Filing at 44-49; Response at 14-20.

Moreover, in addition to being factually and legally inaccurate, AT&T's continued arguments about investor safeguards are, once again, breathtakingly hypocritical. As we discussed at length in our Response, AT&T (through its merger with MediaOne) will have numerous similar investor safeguards governing its 25+% interest in Time Warner Entertainment (which AT&T insists in the MediaOne docket do not amount to attributable control). Response at 18-20. AT&T offers no rejoinder at all regarding its TWE investor protections.

We also pointed out in our Response that AT&T enjoys a full set of virtually identical investor safeguards in its merger agreement with MediaOne. *See* Response at 20; First Gilson Decl. ¶ 26 (setting forth a table comparing AT&T-MediaOne investor safeguards with those proposed for DataCo). AT&T claims that its MediaOne safeguards are very different because they are mere "negative covenants" whose breach only gives AT&T the right to walk away from the deal. AT&T Ex Parte at 12. This is false. Under its merger agreement with MediaOne, AT&T also has the right, in addition to walking away from the deal, to sue MediaOne for damages from any such breach (damages which, in the case of the AT&T-MediaOne deal, would undoubtedly be *Pennzoil*-like in size) and probably also for specific performance. Gilson Supp. Decl. ¶ 30. These are the very same remedies Bell Atlantic/GTE would have for the enforcement of its proposed consent rights. *Id.* AT&T also tries to distinguish its MediaOne safeguards on the ground that they were negotiated at arm's length, AT&T Ex Parte at 12, but the fact that an arm's-length negotiation produced virtually identical investor protections only confirms that our proposed safeguards are reasonable and routine.

Finally, AT&T rehashes its earlier assertion that the reasonable commercial contracts between Bell Atlantic/GTE and DataCo will give the former control over the latter. As we explained in our Response, however, these contracts will do the opposite by ensuring that DataCo remains strong and viable and able to transition into a stand-alone entity. *See* Response at 24. Moreover, the transitional services arrangements and other contracts listed in Schedule B of our Supplemental Filing will be commercially reasonable and structured in a way that eliminates any potential for the exercise of *de facto* control over DataCo. For example, each contract for the provision of transitional administrative support services will be limited to a reasonable period, such as one year, will be

terminable upon reasonable notice by DataCo, and will only be renewable by DataCo at its option. Response at 25.[9]

In sum, and as our Supplemental Filing and Response establish conclusively, Bell Atlantic/GTE will not "control" DataCo within the meaning of the Communications Act before exercising its option.

CONCLUSION

The securities sources offered up by AT&T and its securities expert have absolutely no bearing on the issues of ownership and control under sections 3(1) and 271. They are a "messy digression" into an irrelevant field meant only to muddy the clear and compelling principles of corporate law that support the validity of the DataCo proposal. The specific option structure we propose will remove DataCo as an "affiliate" and will eliminate any "participation" by Bell Atlantic/GTE in the interLATA operations of DataCo. It will, moreover, affirmatively promote the underlying purposes of section 271 (utterly ignored by AT&T in its latest submission) by creating, in the most recent words of this Commission, "powerful new incentives" for Bell Atlantic to complete the 271 approval process in its in-region states as expeditiously as possible. *U S WEST/Qwest Order*, CC Docket No. 99-272, ¶ 2 (rel. Mar. 10, 2000).

[9] AT&T speculates that Bell Atlantic/GTE might control the "lifeblood" of DataCo because BBN Technologies, a division of GTE Internetworking, will remain with Bell Atlantic/GTE after the spin-out. AT&T Ex Parte at 11 & n.13. AT&T's speculation is wrong. BBN Technologies is a separate business from GTE-I's Internet backbone business, and its principal R&D customer is the federal government. GTE-I's backbone operations are not dependent upon R&D from BBN Technologies, and DataCo will not be dependent upon Bell Atlantic/GTE for such support. *See* Declaration of Ira H. Parker, appended hereto.